EUROPEAN CENTRAL BANK

BANKING SUPERVISION

PRESS RELEASE

2 November 2018

EBA stress test shows euro area banks are more resilient to financial shocks

- All 33 banks supervised by ECB now more resilient to financial shocks
- Banks' average capital buffers higher, despite larger capital depletion under more severe adverse scenario than in 2016 stress test
- Average final CET1 under adverse scenario 9.9%, up from 8.8% in 2016
- Adverse scenario depletes average CET1 by 3.8 percentage points, up from 3.3 percentage points in 2016
- Banks show strong capital buffer build-up alongside efforts to address legacy assets

The results of the EU-wide stress test coordinated by the European Banking Authority (EBA) show that the 33 largest banks directly supervised by the European Central Bank (ECB) have become more resilient to financial shocks over the past two years. Despite a more severe adverse scenario than in the 2016 stress test, the average CET1 capital ratio of all 33 banks after a three-year stress period was higher at 9.9%, up from 8.8% two years ago.

In total, the EU-wide stress test covered 48 banks, representing 70% of banking assets in the EU. The 33 participant banks under the ECB's supervision account for 70% of euro area banking assets. The EBA published the stress test results today on its website.

Owing to their efforts to address legacy assets together with the consistent build-up of capital in recent years, the average capital base of the 33 banks when they entered the stress test was much stronger, with Common Equity Tier 1 (CET1) standing at 13.7%, up from 12.2% in 2016. CET1 is a key measure of a bank's financial soundness.

"The outcome confirms that participating banks are more resilient to macroeconomic shocks than two years ago. Thanks also to our supervision, banks have built up considerably more capital, while also reducing non-performing loans, and among other things, improving their internal controls and risk governance," said Danièle Nouy, Chair of the ECB's Supervisory Board. "Looking ahead, the test helps us to see where individual banks are most vulnerable and where clusters of banks are most sensitive to certain risks."

Under the adverse scenario, the average capital depletion for the 33 ECB banks in the EBA sample was 3.8 percentage points, up from 3.3 percentage points in the 2016 stress test. The scenario, which was prepared by the European Systemic Risk Board (ESRB) in collaboration with the ECB and EBA, covered a three-year period. It focused on the repricing of global risk premia, adverse feedback loops between low

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growth and weak bank profitability, and private and public debt sustainability concerns. These risks were identified by the ESRB at the end of last year as the most relevant for European economies. The scenario does not take into account more recent events. With an assumed euro area gross domestic product (GDP) contraction of 2.4% and a fall in real estate and equity prices of 17% and 31% respectively, it contains a more severe shock than that applied in the 2016 stress test scenario, on average across all Member States.

The larger capital depletion reflects not only a more severe macroeconomic scenario, but also the introduction of International Financial Reporting Standard 9. This new accounting standard requires banks to provision for expected losses from impaired loans earlier in the credit cycle, at least those banks that did not benefit from a phasing-in period. The impact of the scenario was also stronger owing to changes in the stress test methodology. On a positive note, having reduced their volumes of non-performing loans, banks benefited from improvements in asset quality.

The overall high level of resilience achieved by the euro area banking system, however, should not hide the fact that challenges remain, and that there is still work to be done on business models and legacy issues. The ECB will carefully monitor developments in these areas.

In parallel to the EU-wide EBA stress test, the ECB conducted its own stress test for those banks that are under its direct supervision, but not covered in the EBA sample.

Earlier this year, the ECB also tested the four Greek banks it directly supervises. While following the same methodology and approach as the EU-wide EBA stress test, it followed an accelerated timetable to complete the test before the end of the third European Stability Mechanism support programme for Greece.

As in past years, the stress test is not a "pass or fail" exercise. However, it helps the supervisor to determine Pillar 2 capital in its annual Supervisory Review and Evaluation Process (SREP). Supervisors ask banks to build up Pillar 2 capital as a prudential capital buffer in addition to the legally required minimum capital. Pillar 2 is tailored to a bank's characteristics, such as its business model, governance structure or risk management framework. The ECB is currently preparing the 2018 SREP decisions for the banks it supervises.

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NOTES:

For ease of comparison, all CET1 capital ratios mentioned here reflect the "fully loaded" basis, which assumes that banks already fulfil all regulatory capital requirements that are subject to transitional arrangements.

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